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Person To Contact:

, ID No.

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Refer Reply To:

CC:PSI:B01

PLR-113735-09

Date: July 31, 2009

Legend

X =

Y =

A =

Trust 1 =

Trust 2 =

Trust 3 =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Dear :

This responds to a letter dated February 6, 2009, submitted on behalf of X from X's authorized representative, requesting inadvertent termination relief pursuant to § 1362(f) of the Internal Revenue Code.

Facts

The information submitted states that X was incorporated under the laws of State on Date 1 and elected to be treated as an S corporation, effective Date 2. X has owned all of the outstanding stock of Y at all times since Date 2. X elected to treat Y as a qualified subchapter S subsidiary (QSub) effective Date 2.

On Date 3, A, a shareholder of X, established three irrevocable trusts, Trust 1, Trust 2 and Trust 3 (together, the Trusts). On Date 4, A transferred shares of X to each of the Trusts. X represents that each of the Trusts qualifies to be a qualified subchapter S trust (QSST) under § 1361(d), and that each of the Trusts was intended to qualify as a QSST. The income beneficiaries for each trust intended to file an election for Trust 1, Trust 2 and Trust 3, respectively, to be treated as a QSST. However, all income beneficiaries inadvertently failed timely to file the appropriate election under § 1362(d)(2). Therefore, both X's S corporation election and Y's QSub election terminated as of Date 4.

X represents that the circumstances resulting in the termination of X's S corporation election and Y's QSub election were inadvertent and were not motivated by tax avoidance. X also represents that each of the beneficiaries of the Trusts reported their allocable shares of the Trusts' income consistent with the treatment of the Trusts as QSSTs on all affected returns. X and its shareholders have agreed to make such adjustments (consistent with the treatment of X as an S corporation and Y as a QSub) as may be required by the Secretary.

Law and Analysis

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under §1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides, in relevant part, that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in §1361(c)(2), or an organization described in §1361(c)(6)) who is not an individual.

Section 1361(b)(3)(A) provides that, except as provided in regulations prescribed by the Secretary, for purposes of the Code -- (i) a corporation which is a qualified subchapter S subsidiary shall not be treated as a separate corporation, and (ii) all assets, liabilities, and items of income, deduction, and credit of a qualified subchapter S subsidiary shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.

Section 1361(b)(3)(B) provides that, for purposes of § 1361(b)(3), the term "qualified subchapter S subsidiary" means any domestic corporation which is not an ineligible corporation (as defined in § 1361(b)(2)), if -- (i) 100 percent of the stock of such corporation is held by the S corporation, and (ii) the S corporation elects to treat such corporation as a qualified subchapter S subsidiary.

Section 1361(b)(3)(C)(i) provides that, for purposes of the Code, if any corporation which was a qualified subchapter S subsidiary ceases to meet the requirements of § 1361(b)(3)(B), such corporation shall be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before such cessation from the S corporation in exchange for its stock.

Section 1361(c)(2)(A)(i) provides that for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of Chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1361(c)(2)(B)(i) provides that, for purposes of § 1361(b)(1), in the case of a trust described in § 1361(c)(2)(A)(i), the deemed owner shall be treated as the shareholder.

Section 1361(d)(1) provides, in relevant part, that in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2) -- (A) such trust shall be treated as a trust described in § 1361(c)(2)(A)(i) and, (B) for purposes of § 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1361(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply. Section 1361(d)(2)(D) provides that an election under § 1361(d)(2) shall be effective up to 15 days and 2 months before the date of the election.

Section 1.1361-1(j)(6)(ii) of the Income Tax Regulations provides that the current income beneficiary of the trust must make the election under § 1361(d)(2) by signing and filing with the service center with which the corporation files its income tax return the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1362(d)(2)(A) provides that an election under § 1362(a) will be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that the termination shall be effective on and after the date of cessation.

Section 1362(f) provides that if -- (1) an election under § 1362(a) or § 1361(b)(3)(B)(ii) by any corporation was terminated under § 1362(d)(2) or (3) or § 1361(b)(3)(C), (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation or a QSub, as the case may be, and (4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation or a QSub, as the case may be) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such termination, such corporation shall be treated as an S corporation or a QSub, as the case may be, during the period specified by the Secretary.

Conclusion

Based solely on the representations made and the information submitted, we conclude that X's S corporation election terminated under § 1362(d)(2) on Date 4 because QSST elections were not filed for Trust 1, Trust 2 and Trust 3. As a result, we also conclude that Y's QSub election terminated under § 1361(b)(3)(C)(i) on Date 4 when Y was no longer wholly-owned by an S corporation. We further conclude that these terminations were inadvertent within the meaning of § 1362(f). Accordingly, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 4 and thereafter, provided that the respective income beneficiaries for Trust 1, Trust 2 and Trust 3 file a QSST election with the appropriate service center, effective Date 4, within 60 days following the date of this letter. A copy of this letter should be attached to each of the QSST elections. Further, Y will be

treated as a QSub of X from Date 4 and thereafter, provided that Y's QSub election was otherwise valid and has not otherwise terminated.

Additionally, Trust 1, Trust 2 and Trust 3 will be treated as QSSTs described in § 1361(d)(3), and each of the beneficiaries of the Trusts will be treated as the owner of the X stock held by the respective Trusts, provided that the respective income beneficiaries for Trust 1, Trust 2 and Trust 3 file a QSST election with the appropriate service center, effective Date 4, within 60 days following the date of this letter.

All of X's shareholders, in determining their respective income tax liabilities from Date 4 and thereafter, must include their pro rata share of the separately stated items of income (including tax-exempt income), loss, deduction, or credit and non-separately stated computed items of income or loss of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368.

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code. Specifically, we express or imply no opinion on whether X is otherwise eligible to be treated as an S corporation, whether Y is otherwise eligible to be treated as a QSub, or whether Trust 1, Trust 2 or Trust 3 are eligible to be treated as QSSTs.

This ruling letter is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,

David R. Haglund

David R. Haglund
Acting Chief, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for §6110 purposes